IN THE

Supreme Court of the United States

OCTOBER TERM, 1937.

No. 597

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

CLARENCE M. FREEDMAN,
Respondent.

BRIEF OF AMICUS CURIAE FILED ON BEHALF OF CHARLES C. STILWELL.

BRIEF OF AMICUS CURIAE.

We are filing this brief as *amicus curiae* on behalf of Charles C. Stilwell, the respondent in a case now pending on an appeal by the Commissioner of Internal Revenue from a decision of the Board of Tax Appeals to the Circuit Court of Appeals for the Seventh Circuit. The case is not yet docketed in that court and the decision of the Board of Tax Appeals is not reported.

We believe this court should be informed of the sole contention made by the Government in the *Stilwell* case be-

cause a similar contention is one of the contentions made in the *Freedman* case which is now before this court. That contention relates to the provision made by the state for compensation and in the *Stilwell* case involves fees, paid by authority of the state, to masters in chancery who perform services peculiar to the operation of government.

Stilwell was and is a master in chancery, appointed under the laws of the State of Illinois for the statutory term of two years. The Board of Tax Appeals held that he was an officer of the State of Illinois, performing a governmental function, and that his compensation, although not paid as a salary by the state, was not subject to federal income tax. In so holding, the Board followed its earlier decision in *Cochrane* v. *Commissioner,* 26 B. T. A. 1167, which involved the same question with regard to another Illinois master in chancery. In both cases the Government, while not denying that these masters were officers of the state, contended that, since under the state statutes these masters in chancery were not paid a salary by the state but received fees which were paid by litigants, their compensation was not immune from federal income tax.

The opinion in the *Cochrane* case recites the following stipulated facts (26 B. T. A. 1167):

> "The appointment of masters in chancery is authorized by the statutes of Illinois (see chapter 90, Smith-Hurd Illinois Revised Statutes, 1929). The statutory term of office is two years. The duties of the office are prescribed by the statute, which also provides for compensation in the form of fees, some of which are statutory and some fixed by the court. The masters are required to take an oath of office and to give bond."

The question presented on the appeal in the *Stilwell* case is the same question, involving the same taxpayers, that was presented and decided in the *Cochrane* case. That was

a test case, as appears by the stipulation of facts in the *Stilwell* case, and the Commissioner not only took no appeal in the *Cochrane* case but expressly acquiesced in the decision in favor of the exemption claimed. The *Stilwell* case is an attempt to try the same question over again for later years and presents the additional question of *res judicata* with which this court is not now concerned. But this court is concerned with the fact that for many years the Commissioner has ruled that in the case of unquestioned state officers the fact that they were compensated by fees had nothing to do with the right to exemption from a federal tax. A ruling was in fact made as early as 1918 in favor of the exemption of fees paid to Illinois masters in chancery, and this ruling remained in force until the question was raised in the *Cochrane* case as a test case in 1932.

It is of course a well known fact that justices of the peace in many states are paid by fees, but the Commissioner apparently has never raised any question about the taxability of such fees. And yet masters in chancery in many states, and certainly in Illinois, perform a governmental service which is of as much or greater importance than that rendered by justices of the peace. Many other state officers were also paid by fees and their right to exemption was not questioned until very recently.

Down to 1935 Article 643 of Regulations 77, as well as the corresponding provision of earlier regulations, was consistent with this view. It was a regulation made by the Secretary of the Treasury for the guidance of the Commissioner, was accepted as an interpretation of the decisions of this court regarding the constitutional exemption of state officers from federal taxation, and was not changed until 1935. Then the Treasury Department presumed not

only to reverse its own practical construction of this question during prior years, but also to issue a regulation (Article 116-2 of Regulations 86) which is inconsistent, in many respects at least, with express decisions of this court and with the reasoning upon which this court has based all of its decisions on this constitutional question.

This court has never held or suggested that the compensation of a state officer exercising distinctively governmental functions is subject to federal taxation if his compensation is derived from fees instead of from state funds. The fundamental inquiry in this court has always been the nature of the employment. This is the question that is carefully reviewed and considered in a recent case decided by this court, *Brush* v. *Commissioner*, 300 U. S. 352.

The dissenting justices in the *Brush* case made it clear that they disagreed only with reference to the character of the employment in that case and emphasized the fact that the services in question were of a character similar to those rendered to private employers. Mr. Justice Roberts, in his dissenting opinion (p. 377) says:

> "We are here concerned only with the question of the taxation of salaries or compensation received by those rendering to a municipality services of the same kind as are rendered to private employers and need not go beyond the precise issue here presented. * * * Nor are we called upon here to determine the validity of a nondiscriminatory tax upon the salary of a governmental officer whose duties and functions have no analogue in the conduct of a business or the pursuit of a profession, but are both peculiar to and essential to the operation of government."

In the *Stilwell* case we are concerned with services which admittedly are "peculiar to and essential to the operation of government," and the sole question involved is the method by which payment is provided for by the state.

Surely, in such a case it is for the state to determine how funds shall be provided to pay for the services of such an essential state officer. If the state provides for payment the compensation must be exempt from tax by the federal government no matter how or by whom the authorized payment is made.

A confusion of ideas is involved when an attempt is made to distinguish or question the source of the fund with which a governmental officer is paid. All the revenues of the state have the same source, and it is not necessary that funds to pay state officers shall first be paid out of general taxes into the state treasury in order that they may be regarded as state funds. If the state has the power to require persons directly benefited to pay for the governmental services rendered by a state officer, the federal government has no right to question the validity of the exaction or claim that the payment is not made out of state funds. Certainly when we are concerned with such governmental officers as justices of the peace and masters in chancery, whose compensation by many states over a long period of time has been provided for by fees paid by litigants, it is too late now for the federal government to raise a question about the source of the funds which provide such payments and require the states to change well established practices in order to avoid interferences by the federal government with the operation of their admittedly essential governmental functions.

The authorities have uniformly sustained this view of the matter.

The Circuit Court of Appeals for the Sixth Circuit so stated in *Bettman* v. *Warwick*, 108 Fed. 46, in an opinion written by Judge Lurton, subsequently Mr. Justice Lurton, of this court. He held that the question of tax im-

munity of a notary public was not determined by the source of the officer's compensation:

> "* * * That his services are compensated by fees and not by a salary, is of no importance. Many more important officials of the state are paid by fees. It is for the government that appoints him to determine how he shall be paid, and he is no less a governmental official because paid by fees * * * than if paid a stipulated salary out of the treasury of the state." (p. 48.)

In deciding the *Cochrane* case the Board followed this decision, pointing out that in many of the states "the so-called fee system is widely employed as a means of providing compensation for state, county and municipal officers employed in the performance of duties clearly of a strictly governmental nature. The alternative of the fee system would necessarily require the payment of the compensation of these officers out of public funds." (26 B. T. A. 1167, at p. 1171.)

Our view is supported by the decision of the Circuit Court of Appeals for the Fifth Circuit in *Therrell* v. *Commissioner*, 88 F. (2d) 869, now pending in this court, and by the recent decision of this court in *New York ex rel Rogers* v. *Graves*, 299 U. S. 401. In the latter case although the funds used to pay the employee's salary did not come from federal taxes but from the revenues of the Panama Railroad, a federal instrumentality, this court, without even commenting upon the source of the funds, held that the compensation was exempt from state taxation.

We submit therefore that the fundamental question which this court must consider in the *Freedman* case, particularly in view of its opinions in the *Brush* case, is the question of the nature and character of Freedman's employment. If it should be held that he is in the exercise of a peculiarly governmental function, then, in view of the authorities, the

source of his compensation should not affect the result, because the taxation of his compensation would be an unconstitutional interference with the power of the state in the discharge of its governmental activities.

Respectfully submitted,

HERBERT POPE,
Amicus Curiae.

Chicago, December 10, 1937.

We hereby consent to the filing of the foregoing brief.

.....,
Counsel for Petitioner.

.....,
Counsel for Respondent.

SUPREME COURT OF THE UNITED STATES.

Nos. 128, 129, 287, 597.—October Term, 1937.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, 128 *vs.* John H. Therrell, also known as J. H. Therrell. Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, 129 *vs.* William H. Tunnicliffe.	Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.
Edward McLoughlin, Petitioner, 287 *vs.* Commissioner of Internal Revenue.	Certiorari to the United States Circuit Court of Appeals for the Second Circuit.
Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, 597 *vs.* Clarence H. Freedman.	Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[February 28, 1938.]

Mr. Justice McReynolds delivered the opinion of the Court.

Has the Federal Government power to tax compensation paid to attorneys and others out of corporate assets for necessary services rendered about the liquidation of an insolvent corporation by a state officer proceeding as required by her statutes?

The opinions below state the essential facts—not in dispute; make adequate references to the relevant statutory provisions; and cite numerous authorities.

No. 128.

Under Florida statutes when a bank becomes insolvent "The State Comptroller may appoint a liquidator [subject to dismissal] to take charge of the assets and affairs of such bank . . .

[who,] under the direction and supervision of the Comptroller, shall take possession of the books and records and assets of every description . . . and in his name shall sue for and collect all debts and claims belonging to it, and upon the order of the court of competent jurisdiction may sell or compound all bad or doubtful debts and on like order may sell all real and personal property . . . and sue for and enforce the individual liability of the stockholders." He shall "pay all money received by him to the State Treasurer to be held as a special deposit . . . shall make quarterly reports, or when called upon, to the Comptroller." The appointment must follow notice and be confirmed by the Circuit Court. Liquidation expenses are payable out of the corporate funds held by the Treasurer. "The compensation of the liquidator shall be fixed by the Comptroller and shall be based upon the amount of work actually and necessarily performed, and shall in no case exceed five per cent of the cash collected."

Respondent Therrell, liquidator for several banks, devoted substantially all his time to the work. He held no commission from the Governor, took no oath of office but was formally appointed by the Comptroller and gave bond. His compensation, for 1931 and 1932, paid from corporate assets, was assessed by the Commissioner for federal income taxes. The Board of Tax Appeals approved; but the Circuit Court of Appeals found immunity under the Federal Constitution.

No. 129.

Respondent Tunnicliffe, liquidator of insolvent banks appointed by the Comptroller of Florida, was assessed for federal income taxes upon the sums received for services during 1931 and 1932. The Board of Tax Appeals approved; the Circuit Court of Appeals ruled otherwise upon its opinion in No. 128. Both causes present the same points.

No. 287.

Petitioner McLoughlin was employed by the Insurance Department of New York as legal counsel in the Liquidation Bureau and received for services during 1932, $5,125.00. This bureau is in charge of a Deputy Superintendent of Insurance a civil service employe whose salary is paid by the State. It employs many persons—superintendents, attorneys, bookkeepers, stenographers, adjusters, accountants, etc.

Under the statutes the Superintendent may apply to the court for an order to take over the assets of an insolvent insurance company and liquidate its affairs. When this issues the corporate charter is dissolved and the Superintendent must proceed to collect assets, adjust claims, etc. He determined petitioner's compensation and caused it to be paid from assets of the several companies in liquidation according to the time devoted to each.

The Commissioner assessed this compensation for federal income tax; the Board of Tax Appeals approved. The Circuit Court of Appeals affirmed, and definitely held it was not exempted by the Federal Constitution.

No. 597.

Freedman, employed as an attorney in Pennsylvania's Department of Justice, received annual salary of $3,000.00. The Attorney General has power to appoint attorneys to represent any department, board or commission of the State and fix their compensation. The Secretary of Banking has broad powers over banks. When one becomes unsound he may, after notice and hearing and with the Attorney General's consent, take possession and wind up its affairs. All necessary expenses, including compensation of attorneys, special deputies, assistants and others employed about the proceedings, are paid from funds of the corporation.

During 1932 the respondent was assigned for legal work relating to closed banks and was paid by the Secretary of Banking out of their funds. The Commissioner assessed the sum so received for federal income tax. The Board of Tax Appeals approved; the Circuit Court of Appeals declared the salary exempt.

What limitations does the Federal Constitution impose upon the United States in respect of taxing instrumentalities and agencies employed by a State and, conversely, how far does it inhibit the States from taxing instrumentalities and agencies utilized by the United States, are questions often considered here. *McCulloch* v. *Maryland* (1819), 4 Wheat. 316; *Weston* v. *City of Charleston* (1829), 2 Pet. 449; *Dobbins* v. *The Commissioners of Erie*, 16 Pet. 435; *Lane County* v. *Oregon*, 7 Wall. 71; *Veazie Bank* v. *Fenno*, 8 Wall. 533, 556; *South Carolina* v. *United States*, 199 U. S. 437, 457; *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514; *Indian Motocycle Co.* v. *United States*, 283 U. S. 570; *Burnet* v. *Jergins Trust*, 288 U. S. 508, 516; *Ohio* v. *Helvering*, 292 U. S. 360, 368; *Helvering* v.

Powers, 293 U. S. 214; *Rogers* v. *Graves,* 299 U. S. 401; *Brush* v. *Commissioner,* 300 U. S. 352.

The Constitution contemplates a national government free to use its delegated powers; also state governments capable of exercising their essential reserved powers; both operate within the same territorial limits; consequently the Constitution itself, either by word or necessary inference, makes adequate provision for preventing conflict between them.

Among the inferences which derive necessarily from the Constitution are these: No State may tax appropriate means which the United States may employ for exercising their delegated powers; the United States may not tax instrumentalities which a State may employ in the discharge of her essential governmental duties—that is those duties which the framers intended each member of the Union would assume in order adequately to function under the form of government guaranteed by the Constitution.

By definition precisely to delimit "delegated powers" or "essential governmental duties" is not possible. Controversies involving these terms must be decided as they arise, upon consideration of all the relevant circumstances. Notwithstanding discordant views which have sometimes arisen because of varying emphasis given to one or another of such circumstances, it is now settled doctrine that the inferred exemption from federal taxation does not extend to every instrumentality which a State may see fit to employ. Exemption depends upon the nature of the undertaking; it is cabined by the reason which underlies the inference.

Veazie Bank v. *Fenno, supra,* sustained a tax laid by the Federal Government upon notes issued by state banks, notwithstanding the view entertained by two Justices that it amounted to "taxation of the powers and faculties of the state governments, which are essential to their sovereignty, and to the efficient and independent management and administration of their internal affairs."

South Carolina v. *United States, supra,* gave occasion for much consideration of the Federal Government's power to tax instrumentalities utilized by a State. It ruled, against a stout dissent, that although South Carolina had the right to control the sale of liquors through the dispensary system nevertheless Congress could tax the dispensers who acted as agents of the State in making sales. "Looking, therefore, at the Constitution in the light of the conditions surrounding at the time of its adoption, it is obvious that the framers in granting full power over license taxes to the National

Government meant that that power should be complete, and never thought that the States by extending their functions could practically destroy it."

Burnet v. *Jergins Trust, supra,* upheld a federal tax upon the receipts by the lessee of oil lands which belonged to the City of Long Beach, California. "The subject of the tax is so remote from any governmental function as to render the effect of the exaction inconsiderable as respects the activities of the city."

In *Ohio* v. *Helvering, supra,* we held that the agencies and operations of the State of Ohio in the conduct of its Department of Liquor Control were subject to excise taxes prescribed by Congress. "Whenever a State engages in a business of a private nature it exercises non-governmental functions and the business, though conducted by the State, is not immune from the exercise of the power of taxation which the Constitution vests in the Congress."

Helvering v. *Powers, supra,* ruled that the compensation of members of the Board of Trustees of the Boston Elevated Railway Company was subject to the federal income tax notwithstanding they were appointed by the Governor of the State, confirmed by the Council, and endowed with large powers to regulate and fix fares, etc. "The fact that the State has power to undertake such enterprises, and that they are undertaken for what the State conceives to be the public benefit, does not establish immunity."

The cases last referred to strikingly illustrate the outcome of efforts here to apply the recognized doctrine in respect of taxing State agencies. According to them and others of like nature due weight, we are unable to conclude that the Commissioner erred in making any one of the assessments involved in the four cases presently before us. He gave proper application to the rule which we must recognize as established. The compensation of the taxpayers was paid from corporate assets—not from funds belonging to the State. No one of them was an officer of the State in the strict sense of that term. The business about which they were employed was not one utilized by the State in the discharge of her essential governmental duties. The corporations in liquidation were private enterprises; their funds were the property of private individuals.

It follows that the judgments in Nos. 128, 129 and 597 must be reversed; the judgment in No. 287 must be affirmed.

Mr. Justice CARDOZO and Mr. Justice REED took no part in the consideration or decision of this case.